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No. 429

In the Supreme Court of the United States

OCTOBER TERM, 1942

HURLBUT W. SMITH, PETITIONER

v.

FRANK J. SHAUGHNESSY, COLLECTOR OF INTERNAL REVENUE OF THE UNITED STATES FOR THE TWENTY-FIRST DISTRICT OF NEW YORK

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The opinion of the District Court (R. 36) is reported in 40 F. Supp. 19. The opinion of the Circuit Court of Appeals (R. 57) is reported in 128 F. (2d) 742.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 6, 1942 (R. 58-59). The petition for a writ of certiorari was filed September 29, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the grantor of a trust of securities, under which the income is to be paid to the grantor's wife for life and upon her death the principal is to be paid to him if living, and, if he should not then be living, to her legatees or, if she should die intestate, to her intestate successors, is subject to gift tax under Sections 501 and 506 of the Revenue Act of 1932.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix, *infra*, pp. 11 *et seq.*

STATEMENT

On February 26, 1937, the taxpayer created an irrevocable trust the corpus of which consisted of securities valued at $570,937.50. The trust indenture provided that the income should be paid to his wife for life, and upon her death the principal to be paid to him if living, or in the event of his prior death, the principal to be paid to the persons and in the amounts directed in her will, but if she should die intestate, the principal to be paid to the persons and in the amounts provided under New York law as though she had owned outright the corpus of the trust and had died intestate (R. 42–43, 44).

In his gift tax return for 1937 the taxpayer reported the full amount of $570,937.50 as a taxable gift, and paid a tax of $71,674.22 thereon.

Thereafter, the taxpayer filed a claim for refund of the tax on the ground that the transfer did not constitute a taxable gift. The Commissioner rejected the claim and the taxpayer thereupon brought suit in the District Court (R. 43–44).

The District Court held that the transfer in trust constituted a complete and absolute gift only to the extent of the life estate in the taxpayer's wife (R. 45), and accordingly on September 9, 1941, entered judgment of refund to the taxpayer in the amount of $40,109.19 (R. 46–47). The taxpayer did not appeal from the District Court's decision that the value of the life estate was subject to gift tax. On the Commissioner's appeal the Circuit Court of Appeals in a memorandum opinion reversed the judgment of the District Court and remanded the cause with direction to dismiss the complaint, on the authority of its decision in *Herzog* v. *Commissioner*, 116 F. (2d) 591 (R. 57–59).

ARGUMENT

The taxpayer contends that the decision below is apparently in conflict with the decisions of this Court in *Estate of Sanford* v. *Commissioner*, 308 U. S. 39, and *Helvering* v. *Hallock*, 309 U. S. 106. The contention seems to be based on the following arguments: (1) Under the *Sanford* case a gift tax cannot be imposed unless the *inter vivos* transfer is complete, and the transfer in the present case is not complete; (2) in any event since under the *Hal-*

lock case the corpus of the instant trust will be included in the grantor's estate and will be taxed as such, the grantor cannot now be subjected to a gift tax. No conflict among the circuits is asserted. Indeed, petitioner's arguments have been uniformly rejected by the circuit courts of appeals. *Commissioner* v. *Marshall*, 125 F. (2d) 943 (C. C. A. 2d); *Commissioner* v. *McLean*, 127 F. (2d) 942 (C. C. A. 5th); *Helvering* v. *Robinette*, 129 F. (2d) 832 (C. C. A. 3d); *Herzog* v. *Commissioner*, 116 F. (2d) 591 (C. C. A. 2d); cf. *Higgins* v. *Commissioner*, 129 F. (2d) 237 (C. C. A. 1st); *Commissioner* v. *Beck's Estate*, 129 F. (2d) 243 (C. C. A. 2d), and *Hughes* v. *Commissioner*, 104 F. (2d) 144 (C. C. A. 9th).

(1) In *Estate of Sanford* v. *Commissioner*, 308 U. S. 39, and *Rasquin* v. *Humphreys*, 308 U. S. 54, this Court held that the grantor of an *inter vivos* trust who reserves the power to designate new beneficiaries other than himself, is subject to a gift tax at the time he relinquishes that power but not before then. Those cases are premised on the proposition that a transfer by which the transferor retains the power to alter the transferees is so incomplete that it does not constitute a gift. Petitioner seeks to expand those decisions to make them applicable to a transfer by which the grantor parts completely with control over the property, and its distribution, but reserves a contingent reversionary

interest. The circuit courts have without exception dismissed attempts of this sort.

The petitioner's argument overlooks the distinction between a grantor's retention of a continuing power to alter the distribution of the property and his retention of a contingent interest, the fruition of which depends upon events wholly beyond his control. Where the grantor retains the power to shift the enjoyment of the fund, even though he is excluded as a possible beneficiary of that power, the absence of a complete donation is at once apparent, for the grantor has retained one of the most significant fagots of the bundle of rights constituting ownership, *viz.*, the right to dispose of the property. Stated another way, the grantor in such a case retains control over the economic benefits of the property. In that circumstance the reason for the nonapplication of the gift tax becomes at once apparent. The gift is not effected until the relinquishment of the power because until that time the *sine qua non* of a complete donation, *viz.*, the surrender of the grantor's control over the economic benefits of the property, does not take place. However, the grantor in this case retained no control over the economic benefits of the property. *Commissioner* v. *Marshall*, *supra*. It is this control or "'command over the property taxed'" which was said in the *Sanford* case to be the essence of the taxable gift. And the relinquishment of this control makes the gift taxable.

In urging that the transfer is at present incomplete the petitioner also emphasizes the indefiniteness of the identity of the ultimate donees. Relying upon the provision of the trust that the wife may dispose of the trust estate by her will, he argues that where the remaindermen are so indeterminable there can be no completed gift of the entire estate. A taxable gift *inter vivos* must, he contends, be a complete bilateral transaction involving a transfer to a determinable donee. Reliance is placed (Pet. 10) on language appearing in the decisions of the Second Circuit in *Porter* v. *Commissioner*, 60 F. (2d) 673, 674, affirmed, 288 U. S. 436, and *Hesslein* v. *Hoey*, 91 F. (2d) 954, 956, certiorari denied, 302 U. S. 756. However, in its later decision in *Herzog* v. *Commissioner*, *supra*, p. 595, the Second Circuit said that the language of its earlier decisions, relied on by the taxpayer here, was used only in respect to a power reserved to the grantor and, inferentially, was not applicable to a situation where the grantor had parted with all control over the appointment. Similarly, the *Sanford* case, *supra*, p. 46, which the taxpayer cites at this point (Pet. 10) was addressed, as the succeeding language (pp. 46–47) shows, to the situation in which the *grantor* retains the power to alter the donee. The statement in that case on which the taxpayer relies was merely that Congress could not have intended to impose personal liability upon the donee of a gift of property, so incomplete

that he might be deprived of it *by the donor* the day after he had paid the tax.

The same contention was discussed and rejected in *Herzog* v. *Commissioner*, *supra*, pp. 594–595, and *Helvering* v. *Robinette*, *supra*, pp. 834, 835–836. The test of the incidence of the gift tax is whether the *donor* has completely parted with control over the property. The language of the statute and Article 3 of the Regulations makes it plain that the taxable event is not the absolute vesting of rights in *particular* beneficiaries but the irrevocable divestment of the donor's rights in the property. The argument (Pet. 9–10) that the interests of the remaindermen are wholly dependent upon the mere whim or fancy of a human being would have merit if the whim were that of the grantor. But here the grantor has placed the property beyond his control. Whether he or any particular person will enjoy it is a matter beyond his power to determine.

2. Petitioner's second contention—that the possibility that under the *Hallock* case the corpus of the instant trust will ultimately be included in the petitioner's gross estate precludes the applicability of a gift tax now—is also not borne out by the decisions.

At the very outset, it should be observed that the statute contemplates a certain amount of overlapping between the gift and estate tax provisions, and indeed specifies that the gift tax shall be credited

against the estate tax to the extent that the same property is included in the gross estate.[1]

As an initial matter, the unglossed text of Sections 501 (a) and (b) and 506 of the Revenue Act of 1932 (Appendix, *infra*), the provisions of Articles 2, 3, 17 and 19 of Treasury Regulations 79 (1936 ed.) (Appendix, *infra*), and the legislative history of the gift tax provisions,[2] all establish that the interests here created are subject to the gift tax. Cf. *Commissioner* v. *Beck's Estate*, *supra*, p. 244; *Commissioner* v. *Marshall*, *supra*, p. 945. For gift tax purposes there may be immediate gifts of future interests, whether vested or contingent. *Helvering* v. *Hutchings*, 312 U. S. 393; *United States* v. *Pelzer*, 312 U. S. 399; *Ryerson* v. *United States*, 312 U. S. 405; *Commissioner* v. *Marshall*, *supra*, p. 945; *Helvering* v. *Blair*, 121 F. (2d) 945 (C. C. A. 2d). But the petitioner contends that the doctrines of the *Hallock* and *Sanford* cases, *supra*, must be read as a gloss upon the generality of the provisions imposing the gift tax. It is clear that although the *Sanford* case discusses the correlation between the gift and estate taxes, it does not suggest that the ultimate imposition of the latter precludes the incidence of the former. On the contrary, the case contains an explicit indication that

[1] Section 802, Revenue Act of 1932, c. 209, 47 Stat. 169, as amended by H. J. Res. 60, March 17, 1941, c. 21, 55 Stat. 44.

[2] H. Rep. No. 708, 72d Cong., 1st Sess., p. 27 (1939–1 Cum. Bull., Part 2, 457, 476–477); S. Rep. No. 665, 72d Cong., 1st Sess., p. 39 (1939–1 Cum. Bull. (Part 2), 496, 524–525).

the two taxes are not mutually exclusive. 308 U. S. at 45. And in *Herzog* v. *Commissioner, supra, Commissioner* v. *Marshall, supra,* and *Helvering* v. *Robinette, supra,* the courts approved a gift tax on a transfer such as is here involved notwithstanding the recognized possibility that an estate tax would also be imposed. See also *Higgins* v. *Commissioner, supra.* Nor does the *Hallock* case, which dealt solely with estate taxes, contain any intimation as to the incidence of gift taxes.

Moreover, instances of overlapping are frequently found in the decided cases. Thus, a vested remainder after a retained life estate in the donor is subject to the estate tax. *Helvering* v. *Bullard,* 303 U. S. 297. Yet it is inconceivable that the gift tax would not also attach at the time that the remainder was created. Again, the overlapping of the two taxes is shown in the case of a tenancy by the entirety. *Tyler* v. *United States,* 281 U. S. 497; *Helvering* v. *Bowers,* 303 U. S. 618; *Lilly* v. *Smith,* 96 F. (2d) 341 (C. C. A. 7th), certiorari denied, 305 U. S. 604; *Commissioner* v. *Hart,* 106 F. (2d) 269 (C. C. A. 3d). The taxpayer's contention necessarily assumes that the *Sanford* case has inferentially overruled the foregoing decisions, an assumption that is unwarranted by the opinion.

In the court below the Collector conceded that the value of the grantor's reversionary interest should be deducted from the entire value of the securities transferred in trust. (R. 53; Pet. 7.)

However, the effect of the decision below was to tax the entire value of the trust estate without such reduction. Although this result does not accord with *Commissioner* v. *McLean*, 127 F. (2d) 942 (C. C. A. 5th), the taxpayer nevertheless does not appear to have made a point of this aspect of the decision below (Pet. 5).

CONCLUSION

The decision below is in accord with the decisions in other circuits and is not in conflict with applicable decisions of this Court. It is respectfully submitted that the petition should be denied.

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OCTOBER 1942.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 501. IMPOSITION OF TAX.

(a) For the calendar year 1932 and each calendar year thereafter a tax, computed as provided in section 502, shall be imposed upon the transfer during such calendar year by any individual, resident or nonresident, of property by gift.

(b) The tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible: * * *

* * * * * *

SEC. 506. GIFTS MADE IN PROPERTY.

If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.

Treasury Regulations 79 (1936 ed.):

ART. 2. *Transfers reached.*—The statute imposes a tax whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. Thus, for example, a taxable transfer may be effected by the declaration of a trust, * * *. Inasmuch as the tax also applies to gifts indirectly made, all transactions whereby property or property rights or interests are donatively passed or conferred upon another, regardless of the means or device employed, constitute gifts subject to tax.

ART. 3. [as amended by T. D. 5010, 1940-2 Cum. Bull. 293]. *Cessation of donor's dominion and control.*—The tax is not imposed upon the receipt of the property by the donee, nor is it necessarily

determined by the measure of enrichment resulting to the donee from the transfer, nor is it conditioned upon ability to identify the donee at the time of the transfer. On the contrary, the tax is a primary and personal liability of the donor, is an excise upon his act of making the transfer, is measured by the value of the property passing from the donor, and attaches regardless of the fact that the identity of the donee may not then be known or ascertainable.

As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change the disposition thereof, whether for his own benefit or for the benefit of another, the gift is complete. * * *.

* * * * *

ART. 17. *Gifts made in property.*—A gift made in property is subject to the tax in the same manner as a gift of cash, and the amount of the gift is the value of the property at the date of the gift.

* * * * *

ART. 19. *Valuation of property.*—(1) General.—The statute provides that if the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift. * * *.

* * * * *

(7) *Annuities, life, remainder, and reversionary interests.*—For valuation of annuities purchased from life insurance companies or other companies issuing annuity contracts, see subdivision (9) of this article. In case the donor creates a trust under which a specified annuity is payable to the donee, the value of such gift should be determined by using Table A or Table B, whichever is applicable, shown at the end of this article. * * *

* * * * *

If an annuity is to be paid during the life of an individual and in any event for a definite number

of years, or for more than one life, or in any other manner rendering inapplicable both Table A and Table B, the case may be stated to the Commissioner, who will thereupon make the computation and advise the donor thereof. In making such calculations when life interests or remainders upon life interests are involved, use will be made of the Actuaries' or Combined Experience Table of Mortality, as extended (that being the basis of Table A), with interest at 4 percent per annum compounded annually.

If a gift consists of the donor's right to receive the entire income of certain property during the life of Z, or for a term of years, and the annual rate of income for a period equal to or exceeding the life expectancy of Z, or for such term of years, is fixed or definitely determinable at the time of the gift, then the value of the gift should be computed as explained above in the case of an annuity. If the rate of annual income is not determinable, or if the donor is entitled merely to the use of non-income-producing property, a hypothetical annuity at the rate of 4 percent of the value of the property should be made the basis of the calculation.

If the gift is of a remainder or reversionary interest subject to an outstanding life estate, the value of the gift will be obtained by multiplying the value of the property at the date of the gift by the figure in column 3 of Table A opposite the number of years nearest to the age of the life tenant. In case the remainder or reversion is subject to an estate for a term of years, Table B should be used.

* * * * *

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